IN THE HIGH COURT OF JUDICATURE AT MADRAS

DATED: 17/12/2003

CORAM

THE HON'BLE MR.JUSTICE R.JAYASIMHA BABU
and
THE HON'BLE MR.JUSTICE S.R.SINGHARAVELU

T.C.No.59 of 2000 and T.C.No. 228 of 2000

Shri V.R.Chinnan Chettiar,
Kandannor. ..Applicant

-Vs-

Commissioner of Income-tax,
Madurai. ..Respondents

!For Applicant : Mr.N.Quadir Huzzain

For respondent : Mrs.Pushya Sitaraman,
Sr. Standing Counsel
for I.T. Department.

:JUDGMENT

(Delivered by R.JAYASIMHA BABU, J.)

The assessee's minor children had been admitted to the benefits of a partnership of which the assessee and his mother were partners. On the capital contribution made by the minors, the distributable profits had been allowed to accumulate. The accumulation as on 1.4.1980 was Rs.1,00,000/- in the accounts of the minors and Rs.50,000/- each in the account of the assessee and his mother. These accumulations had apparently accrued over a long period from 1974 to 1980, the firm having first been constituted in the year 1974 and later reconstituted in the year 1977. On 1.4.1980, the parties entered into an agreement which reads thus:-

"Whereas the parties to this deed along with minor C.Veerappan and C.Subramania, all sons of the party of the first part are running the firm M/s SVR Cycle Mart, Karaikudi in which the above said two minors are admitted to the benefits of partnership and whereas the partners are having balances in their respective current accounts with the firm and whereas the parties expressed their intention to withdraw major balances in current accounts and whereas the business of the firm badly requires finance and after discussion and consultations it has been agreed that the partners shall retain with the firm the following amounts as deposits with the firm for a period of five

years at the rate of 12% p.a. From the first two years and at the rate of 15% p.a. For the balance of three years. Such amount retained as deposit shall be transferred from the current account of the respective partners to their respective deposit account."

2. It is clear from this agreement that as on the date of the agreement, the partners and the two minors had, to their credit, amounts which represented accumulation of the profits and which sums they had so far not drawn. It was open to them to draw these amounts and instead of drawing the same and placing the amounts in deposits in banks or companies so that those amounts could yield interest, they had agreed to treat those amounts as deposits with the firm itself on which the firm was to pay interest. The period for which the deposit was to be retained by the firm as also the rate of interest payable were set out.

3. Though initially the interest paid to the two minors on their deposits were not taxed in the hands of the assessee, the Commissioner, by using his powers under Section 263, made an order requiring the assessing officer to tax those amounts in the hands of the assessee. This he did by completely misreading the judgment of the Supreme Court in the case of S.Srinivasan v. The Commissioner of Income Tax, Madras (1967) 63 ITR 273.

4. The assessing officer having thereafter brought that amount to tax in the hands of the assessee by placing reliance on Section 64 (1) (3) of the Act, the assessee took the matter in appeal successfully, but that success was shortlived as the Tribunal took the view that this amount is required to be taxed in the hands of the assessee.

5. Section 64 (1)(3) of the Act, as it stood at the relevant time, that provision having been repealed with effect from 1.4.93, reads as under:-

"In computing the total income of any individual, there shall be included all such income as arises directly or indirectly.
.....
(iii) to a minor child of such individual from the admission of the minor to the benefits of partnership in a firm."

6. The question which thus required consideration by the Tribunal was as to whether the interest paid on these deposits was capable of being regarded as benefit accruing to the minors by reason of their admission to the benefits of the partnership firm.

7. A case very similar to the present one was considered by the Supreme Court in the case of S.Srinivasan v. The Commissioner of Income Tax (1967) 63 ITR 273. In that case also there was accumulation of undrawn profits of the wife and the minor sons in the firm and on those sums the firm had paid interest. Such payment of interest was held by the Court to be a benefit indirectly obtained by the spouse and the minor children from the firm. While so holding, the Court considered the argument that had been advanced that those amounts were in the nature of loans and deposits. The

Court pointed out that as there was no agreement in that case by which the parties had agreed to treat that amount as loans and deposits they had not been so regarded.

8. The Court observed thus:-

"The profits accumulated to the credit of the wife and the minor sons, because they did not draw their share of profits when distribution of profits took place, and allowed those profits to remain with the firm; but there is no suggestion at all that, at that stage, either the wife or the minor sons, or anyone on their behalf, purported to enter into an arrangement with the firm to keep these accumulated profits and deposits. Similarly, there was no such contract which could convert those accumulations into loans and advances to the firm by these persons."

Those observations of the Court clearly point out that it is the absence of an arrangement or a contract to treat the accumulated undrawn profits as loans and deposits that resulted in the interest paid on those undrawn accumulations as having to be regarded as indirect benefits received by the spouse and the minors who had been admitted to the benefits of the firm.

9. In this case, the undrawn accumulation had been, by an agreement among the parties, treated as deposits and the interest that was paid subsequently was only on that deposit and was not an amount paid as interest on the undrawn accumulation. The fact that the parties had voluntarily agreed that the undrawn accumulation would not be immediately drawn but would be kept with the firm as deposit on which the firm agreed to pay interest does not in any manner render the interest so paid an indirect benefit covered by Section 64 (1) (3) of the Act.

10. The Tribunal's view that the undrawn profits should be regarded as additional capital brought in by the partners cannot be approved, as the later agreement, the genuineness of which has not been doubted, clearly sets out that those profits were to be henceforth held as deposits. The question referred viz.,

'Whether the Tribunal is right in holding that the interest paid by the firm M/s S.V.R.Cycle Mart to the assessee's minor sons VR.C. Veerappan and VR.C.Subramanian is includible in the assessment of the assessee under section 64 (1) (iii) of the Income-tax Act"

is, therefore, answered in favour of the assessee and against the Revenue. The assessee shall be entitled to costs in the sum of Rs.2500/-.

dev/

To

1.The Assistant Registrar,
Income Tax Appellate Tribunal,
Rajaji Bhavan,
III Floor, Besant Nagar,
Madras-90. (with records) (5 copies)

2.The Secretary,
Central Board of Revenue,
New Delhi. (3 copies)

3.The Commissioner of Income Tax,
Madurai.

4.The Inspecting Asst. Commissioner of Income-tax,
Madurai Range, Madurai.

5.The Asst. Commissioner of Income-tax,
Circle 1 (3), Karaikudi.

Dev/